Research Update:

Eurasian Development Bank Affirmed At 'BBB-/A-3'; Outlook Remains Negative

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Overview
• Provisions for impaired loans to customers at Eurasian Development Bank (EDB) increased significantly to $132 million in 2015, from $42 million in 2014, weighing on the bank's profitability and internal capital generation. EDB posted a loss of $143 million in 2015.
• EDB's ability to attract financing in dollars and tenge remains tight. However, there is some progress on bilateral loans from Kazakhstan's authorities.
• We are therefore affirming our ratings on EDB at 'BBB-/A-3', 'kzAA', and 'ruAAA'.
• The negative outlook reflects our view that EDB’s financial profile could weaken further from its current level in the next few months, notably due to weaker than expected performance of its loan portfolio as measured, e.g., by NPLs.

Rating Action
On June 29, 2016, S&P Global Ratings affirmed its long- and short-term foreign currency issuer credit ratings on Eurasian Development Bank (EDB) at 'BBB-/A-3'. The outlook remains negative. At the same time, we affirmed our Kazakhstan national scale rating on the bank at 'kzAA', and affirmed the Russia national scale rating at 'ruAAA'.

Rationale
Our ratings on EDB reflect our view of the bank's strong financial profile and weak business profile. These assessments lead to a stand-alone credit profile (SACP) of 'bbb-'.

Similar to other multilateral lending institutions (MLIs), EDB depends heavily on wholesale market funding, which represents about 90% of its liabilities. We have observed a significant drop in EDB's bond issuance to only $0.3 billion in 2014 from $1.3 billion in 2013, and no new issuance outside Russia in 2015. The decrease stemmed from slow portfolio growth and increased loan repayments by EDB's borrowers; the absence of need for U.S. dollar-denominated funding; and deteriorating conditions in local markets, with higher costs of funding and reduced liquidity.

In our view, EDB's ability to attract financing denominated in tenge and U.S. dollars remains challenging. We think long-term funding in tenge will likely remain tight over the next two years, further straining EDB's ability to place sufficient bonds to support tenge-denominated loan generation. However, we understand the National Bank of Kazakhstan (NBRK) will provide EDB with three-year funding in tenge through sale and repurchase (repo) transactions against U.S. dollar Treasury notes for up to $100, at half the NBRK's base rate, which should help ease EDB's tenge funding gap. The bank is not planning to issue dollar-denominated bonds this year.
because of the substantial devaluation of local currencies and lack of borrower interest in dollar-denominated debt.

The Central Bank of Russia has recently proposed an amendment to Russian banks' capital adequacy calculations that would lead to EDB's foreign-currency-denominated bonds being weighted at 100%. In our view, this regulation, if approved, would put additional pressure on EDB's ability to place new Eurobonds, while narrowing its investor base.

We believe that EDB's public policy mandate may suffer from the bank's pro-cyclical lending. EDB's loan portfolio has shrunk since year-end 2014, due to currency devaluation and loan repayments, and in some cases pre-payment by borrowers. At the same time, the bank signed only two new loans over that period for an equivalent of $23 million. Our view on EDB's liquidity position remains unchanged because the liquidity cushion is ample, with $1.3 billion of liquid assets in excess of the bank's gross debt calculated at $1.2 billion as of December 2015.

EDB's risk-adjusted capital (RAC) ratio increased to 27% as of December 2015, from 23% at year-end 2014, due to contraction of risk-weighted assets and the bank's loan portfolio. EDB's balance sheet remains highly concentrated. Most of its loans to customers are in Russia and Kazakhstan (72.5%), and the 10 largest loans account for 52.8% of the purpose-related loans. After factoring in these concentrations, the RAC ratio after adjustments stood at 18% on Dec. 31, 2015.

We observe increasing pressure on the bank's asset quality and internal capital generation capacity, amid a worsening macroeconomic environment. EDB posted a loss of $143 million in 2015, which was primarily due to a significant rise in provisions for impairment losses on loans to borrowers by about $132.7 million. The increase stemmed from reserves for specific loans and the overall portfolio for higher risks in countries of operations, and from foreclosed collateral assets under nonperforming loans (NPLs) where the ability to fully recover losses is doubtful.

There is also evidence that an important change took place at the management level of the bank in 2015. EDB’s Council--the supreme management body of the bank--took place on Feb. 6, 2015 in Moscow and elected Mr. Dmirty Pankin as new Chairman of EDB's Management Board. During the same year, EDB's council took a supplementary decision to appoint three new deputy chairmen of the Bank’s Management Board in February, July, and August 2015.

In addition, the number of projects in EDB's investment portfolio decreased to 62 in 2015 from 88 in 2014 because of repayment of 27 projects totaling $500 million. A deteriorating operating environment, higher interest rates, and tighter credit conditions negatively impact EDB's borrowers' capacity to continue to grow and refinance their debts. The deterioration in the quality of the loan portfolio as the Russian and Kazakhstan economies have slowed down has been faster than we previously anticipated. As of May 2016, the total amount of provisions has continued to increase, reaching 8.6% of the balance portfolio, in comparison with 7.9% on Dec. 31, 2015, and 1.8% on Dec. 31, 2014.
Our ratings on EDB do not incorporate any explicit uplift for extraordinary shareholder support in the form of callable capital. Although callable capital can, in principle, enhance an MLI's SACP and result in a higher issuer credit rating, we factor in no explicit uplift in the case of EDB. This is mainly because of EDB's highly idiosyncratic ownership structure, which exacerbates the principal-agent problem related to capital calls.

Outlook

The negative outlook reflects our view that EDB's financial profile could weaken from its current level, notably due to weaker-than-expected performance of its loan portfolio in the next few months, as measured, for example, by NPLs. A weaker financial profile could also result from further deterioration of EDB's funding profile, as well as from a more significant weakening of the economic environment in the region than we currently anticipate. We could also lower the rating if relations among shareholders deteriorated. Conversely, the ratings could stabilize at their current levels if EDB's financial profile were to stabilize, notably its asset quality and funding.

Related Criteria And Research

Related Criteria

- General Criteria: National And Regional Scale Credit Ratings - September 22, 2014
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers - May 07, 2013
- Criteria - Governments - General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology - November 26, 2012
- Criteria - Financial Institutions - Banks: Bank Capital Methodology And Assumptions - December 06, 2010

Related Research

- Supranationals Special Edition 2015 - October 8, 2015

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.